

# ORIGINAL NEW APPLICATION



0000048820

BEFORE THE ARIZONA CORPORATION COMMISSION

## COMMISSIONERS

JEFF HATCH-MILLER – Chairman  
WILLIAM A. MUNDELL  
MARC SPITZER  
MIKE GLEASON  
KRISTIN K. MAYES

2006 APR -3 P 4: 32

AZ CORP COMMISSION  
DOCUMENT CONTROL

T-03632A-06-0215

IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. T-03632A-06-\_\_\_\_\_  
DIECA COMMUNICATIONS, INC. D/B/A )  
COVAD COMMUNICATIONS COMPANY )  
FOR EXPEDITED APPROVAL TO ENCUMBER )  
ASSETS IN CONNECTION WITH NEW )  
FINANCING )

## APPLICATION

### (EXPEDITED CONSIDERATION REQUESTED)

DIECA Communications, Inc. d/b/a Covad Communications Company (“Covad” or the “Company”), by its attorneys, hereby respectfully requests the Arizona Corporation Commission (“Commission”) to authorize Covad to encumber its assets in the State of Arizona in connection with its guarantee, or other provision of security related to various financings of up to \$200 million being arranged for its parent company, Covad Communications Group, Inc. (“Covad Group”) (Covad and Covad Group, collectively the “Borrowers”). Covad requests this authority pursuant to A.R.S. §40-285.<sup>1</sup> Covad is not a Class A utility subject to the Commission’s Public Holding Company and Affiliated Interest Rules. Moreover, in Arizona, Covad provides telecommunications service with physical facilities that are used in providing service in interstate commerce.

In support of this Application, Covad provides the following information:

<sup>1</sup> Although Covad is seeking any necessary approval for its participation in this financing transaction, Covad is doing so without prejudice to its right to assert that this transaction is beyond the jurisdiction of the state commissions. *See, e.g., State ex rel. Utils. Comm’n v. S. Bell Tel. & Tel.*, 207 S.E.2d 772, *aff’d* 217 S.E.2d 543 (N.C. 1975).

**THE APPLICANT**

Covad is a Virginia corporation that is a wholly-owned subsidiary of Covad Group, a Delaware corporation and a publicly-held company. The principal business office of Covad Group and Covad is 110 Rio Robles, San Jose, CA 95134. Covad is a nationwide provider of integrated voice and data communications. The Company offers DSL, VOIP, web hosting, managed security, IP and dial-up, and bundled voice and data services directly through its network and through Internet service providers, value-added resellers, telecommunications carriers, and affinity groups to small- and medium-sized businesses and home users. To provide its services, Covad owns and operates a nationwide broadband network that serves customers in 44 states. In Arizona, Covad provides telecommunications service with physical facilities that are used in providing service in interstate commerce.

In Arizona, the Company is authorized to provide competitive resold and facilities-based local exchange and interexchange telecommunications services throughout Arizona pursuant to a Certificate of Convenience and Necessity granted by the Commission in Decision No. 61942. Covad is also authorized by the Federal Communications Commission to provide both interstate and international telecommunications services. Presently, Covad has no customers for intrastate service in Arizona.

**DESIGNATED CONTACTS**

The designated contacts for questions concerning this Petition are:

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Copies of any correspondence should also be sent to the following designated representative of the Petitioner:

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### **DESCRIPTION OF THE TRANSACTION**

Covad proposes that Covad Group and/or Covad obtain up to \$200 million through one or more financing arrangements with banks, other financial institutions and/or other types of investors (the "Financings"). Current proposed Financings include a \$50 million revolving line of credit from a commercial bank (the "Commercial Bank"), as well as a \$50 million investment from Earthlink in return for \$10 million of Covad Group common stock and a \$40 million senior secured convertible note. The Borrowers may obtain other Financings in the future.

The exact amounts and terms of each Financing, which may be completed in multiple tranches, will not be finalized until the specific arrangement(s) have been completed or shortly before funding of the various transactions, and will reflect the market conditions then existing. Some of the terms, such as interest rate, may fluctuate during the term of the Financing due to changes in market conditions and the financial condition and/or the performance of the Borrowers.

1 The terms of each Financing is expected to be substantially as follows:

2 **Funding Providers:** The funding providers may be banks, financial institutions, private  
3 lending institutions, private individuals, and/or other institutions, either individually or a  
4 consortium. The funding group may change over the life of the Financing. As noted previously, it  
5 is expected at present that the Commercial Bank and Earthlink will provide Financings.

6 **Amount:** Up to \$200 million. Portions of the financed funds may be in the form of  
7 conventional credit facilities such as revolving credits (which can be reborrowed during the term  
8 of the commitment); letters of credit; the issuance of secured or unsecured notes or debentures  
9 (including notes convertible into common stock) to banks, other types of financial institutions or  
10 other investors; or term loans. As noted previously, at present, it is expected that the Commercial  
11 Bank will provide a revolving line of credit up to \$50 million. In addition, Earthlink will invest  
12 \$50 million in return for \$10 million of Covad Group common stock and a \$40 million senior  
13 secured convertible note that is convertible into Covad Group common stock.

14 **Maturity:** Any maturity date will be subject to negotiation and will depend on credit  
15 conditions. All maturity dates will be longer than one (1) year.

16 **Interest:** Any interest rate will likely be the market rate for similar Financings and  
17 will not be determined until such time as each Financing is finalized.

18 **Security:** Relevant to this Petition, some and perhaps all of the loans to Borrower(s)  
19 are expected to be secured by a first ranking security interest in specified assets of Covad,  
20 including a security interest in its receivables, tangible personal property, equipment, and  
21 intellectual property. In some cases, Covad may provide guarantees or be a co-borrower. The  
22 security documents will contain appropriate provisions indicating that the exercise of certain rights  
23 thereunder may be subject to obtaining prior regulatory approval. At present, it is expected that  
24 the Commercial Bank line of credit will be secured by Covad's assets. The Earthlink senior  
25 secured convertible note will be secured with a security interest in the telecommunications  
26 equipment (and any intellectual property embedded in that equipment) that Covad will purchase  
27 with the proceeds from the note.

1           *Use of Proceeds:*     Some of the proceeds will be used to repay other loans, or for  
2 general corporate purposes, capital expenses, and working capital. Other proceeds will be used to  
3 fund the acquisition of other telecommunications companies and/or telecommunications assets.  
4 As noted previously, it is expected that the proceeds from the Earthlink note will be used to  
5 purchase telecommunications equipment and associated intellectual property.

6           As noted above, Covad does not currently provide intrastate service in Arizona. All of its  
7 physical assets located in Arizona are used only to provide interstate service. No assets presently  
8 used to provide intrastate service would be encumbered.

9           The proposed financing arrangement – and related encumbrance of assets as security -- is  
10 purely financial in nature, and will not alter the terms, conditions or services offered by Covad in  
11 Arizona. The financing arrangement will not require Covad to increase its maximum rates for  
12 telecommunications services in Arizona. Covad will remain a wholly owned subsidiary of Covad  
13 Group, will continue to operate and provide telecommunications services in Arizona and will  
14 retain the assets used in the provision of those services. Finally, as of March 31, 2006, Covad does  
15 not hold any deposits or prepayments from Arizona customers. Even if Covad did hold such  
16 funds, the proposed financing arrangement would not affect those funds in any way.

#### 17                                   **PUBLIC INTEREST ANALYSIS**

18           Approving this Application will serve the public interest by enhancing the ability of Covad  
19 to grow and compete in the highly competitive markets for telecommunications services in  
20 Arizona and nationwide. Approval of the authority related to the financing transaction described  
21 herein is not expected directly to affect in any way the rates or services of Covad or its affiliates, or  
22 result in any change in control of Covad or its affiliates. The financing arrangement will provide  
23 Covad with the financial resources needed to further grow and expand its business and to compete  
24 in today's highly competitive telecommunications environment.

25           Covad competes in Arizona and other markets with numerous other interexchange carriers  
26 and enhanced service providers as well as the incumbent local exchange carrier and other  
27 competitive local exchange carriers. Because Covad is a non-dominant carrier, it is not subject to

1 rate of return regulation and its capital structure should not be a matter of concern to the  
2 Commission. In addition, because of the highly competitive environment in which it operates, the  
3 rates charged customers are subject to market discipline and the services offered generally are  
4 available from numerous other carriers. As a result, the source of funds and capital structure of  
5 Covad would have little effect on customers in Arizona or elsewhere. In the unlikely event that  
6 the capital structure becomes too costly and rates rise, customers may simply migrate to other  
7 carriers with preferred rates. Thus, any adverse consequences from the financing decisions impact  
8 the shareholders, not the customers, and any favorable consequences benefit both its shareholders  
9 and consumers through higher profits, lower rates, and better services.

10 Moreover, because the public interest is best served by assuring the presence of numerous  
11 telecommunications competitors in Arizona, it is important to provide such competitors with the  
12 flexibility to arrange financing in the manner they deem most appropriate to carry on business so  
13 long as there is no adverse impact on the public. To deny such flexibility would discourage new  
14 competitors from entering the state and would encourage existing competitors in the state to seek a  
15 more favorable regulatory environment elsewhere, neither of which would enhance the public  
16 interest. Given the challenges facing competitive telecommunications carriers, the availability of  
17 funds to Covad in this manner would benefit Arizona consumers.

### 18 CONCLUSION

19 For the reasons stated above, Covad respectfully submits that the public interest,  
20 convenience and necessity would be furthered by granting this Application. Accordingly, Covad  
21 respectfully requests that the Commission approve, to the extent necessary, the encumbrance of its  
22 Arizona assets in connection with its participation in the financing transactions described herein  
23 and further relief as the Commission may deem appropriate. Covad requests that the Commission  
24 grant this application by May 31, 2006.

1 RESPECTFULLY SUBMITTED THIS 3<sup>rd</sup> day of April, 2006.

2  
3 By: 

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17 Of Counsel

18 Original and 13 copies of the foregoing  
19 filed this 3<sup>rd</sup> day of April 2006 with:

20 Docket Control  
21 Arizona Corporation Commission  
22 1200 West Washington Street  
23 Phoenix, Arizona 85007

24 Copies of the foregoing hand-delivered/mailed  
25 this 3<sup>rd</sup> day of April, 2006 to:

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**VERIFICATION**

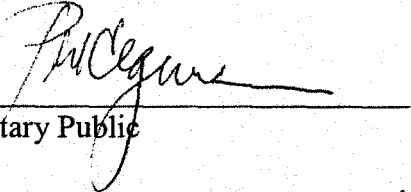
I, Douglas Carlen, am Vice President and Secretary of Covad Communications Group, Inc., and am authorized to represent it and its affiliates, and to make this verification on their behalf. The statements in the foregoing document relating to Covad Communications Group, Inc., and its affiliates, except as otherwise specifically attributed, are true and correct to the best of my knowledge and belief.

I declare under penalty of perjury that the foregoing is true and correct.



Douglas Carlen  
Vice President and Secretary  
Covad Communications Group, Inc.

Subscribed and sworn to before me this 21<sup>st</sup> day of MARCH 2006.



Notary Public

My Commission expires: 3/19/09

